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July 12, 1995

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

Mr. William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, NW - Room 222  
Washington, D.C. 20554

Re: Price Cap Performance Review for Local  
Exchange Carriers CC Docket No. 94-1

Dear Mr. Caton:

Pursuant to Section 1.429 (h) of the Commission's Rules, attached please find an original and eleven copies of the Reply to Oppositions to the Petition for Expedited Partial reconsideration of the Ad Hoc Telecommunications Users Committee in the above captioned matter. Please date stamp the additional copy and return it with our messenger.

If you have any questions regarding this filing, please do not hesitate to call us.

Sincerely,



James S. Blaszak

Before the  
FEDERAL COMMUNICATION COMMISSION  
Washington, D.C. 20554

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JUL 12 1995

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

In the Matter of: )  
)  
Price Cap Performance Review )  
for Local Exchange Carriers )  
)

CC Docket No. 94-1

DOCKET FILE COPY ORIGINAL

**Reply To Oppositions**

The Ad Hoc Telecommunications Users Committee ( the "Ad Hoc Committee" or "Ad Hoc") hereby replies to the oppositions which have been filed to its Petition for Expedited Partial Reconsideration in the above-captioned proceeding.<sup>1</sup> The oppositions do not effectively refute the Ad Hoc Committee's showing that the First Report and Order in this proceeding is arbitrary, capricious and unlawful because the Commission (1) failed to provide a reasoned explanation for relying on Total Factor Productivity ("TFP") data which USTA submitted on January 18, 1995; (2) appears to have concluded that it may eliminate any limit on carriers' earnings by canceling the sharing obligation for carriers who elect to operate under a 5.3% offset factor; and (3) set the offset

<sup>1</sup> Oppositions or comments have been filed by the following parties: BellSouth Telecommunications, Inc. ("BellSouth"), GTE Service Corporation ("GTE"), the NYNEX Telephone Companies ("NYNEX"), Rochester Telephone Corp. ("RTC"), Sprint Corporation ("Sprint"), and the United States Telephone Association ("USTA"). Collectively, these parties are referred to herein as "Opponents."

factor based on company-wide, rather than interstate operations, performance data.

**I. Opponents Fail To Refute Ad Hoc's Showing That The Commission Acted Arbitrarily and Capriciously In Setting The Highest Offset Factor At 5.3 Percent.**

In its Petition for Reconsideration, the Ad Hoc Committee argues that the Commission's decision to rely on USTA's January 18, 1995 "update" to its 1994 TFP study was arbitrary and capricious because the Commission did not address serious inconsistencies in the updated data which the Ad Hoc Committee had pointed out to the Commission<sup>2</sup>. Opponents either ignore this argument, or seem to contend that the USTA "update" is not relevant to the Commission's decision to set the highest offset factor at 5.3%.

Contrary to the Opponents' contentions, the USTA "update" was relevant to and considered by the Commission in setting the highest offset factor at 5.3%. In Appendix D to the First Report and Order in this docket, the Commission concluded that the USTA TFP study should be revised to account for the fact that local exchange carriers have experienced, and will likely continue to experience, input prices which are lower than the input prices which are implicitly reflected in economy-wide indices.<sup>3</sup> Appendix D shows that the Commission relied on USTA's "updated" data in arriving at a TFP-based offset

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<sup>2</sup> Ad Hoc Telecommunications Users Committee, Petition for Expedited Partial Reconsideration, at 2-4. Hereinafter the "Petition for Reconsideration."

<sup>3</sup> *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, FCC 95-132, released April 7, 1995.

factor. The Commission then used the results of Appendix D to confirm its decision to increase the offset factor.

The First Report and Order used updated data, including that used in Appendix D, as the basis for the Commission's decision to eliminate the controversial 1984 data point in calculating an offset factor. However, nowhere does the First Report and Order explain why the Commission chose to use the "updated" USTA TFP data in the Appendix D analysis in the face of serious problems with that data--problems that the Ad Hoc Committee had brought to the Commission's attention. That the Appendix D analysis was relevant to the Commission's adjustment to the offset factor is undeniable. That Appendix D used the "updated" USTA TFP data is also undeniable. And that the Opponents of Ad Hoc's Petition for reconsideration have not explained, and cannot explain, the Commission's decision to rely on the "updated" USTA is also undeniable. The Commission's failure to address the criticisms of the "updated" USTA TFP data was arbitrary and capricious decision-making on a highly relevant matter. Nothing in the oppositions to the Ad Hoc's Petition for reconsideration cures this deficiency in the First Report and Order.

**II. Opponents Fail To Refute Ad Hoc's Showing That The  
First Report And Order Fails To Establish A Rational Basis For  
Eliminating The Sharing Obligation Upon Selection Of  
5.3% As The Offset Factor.**

Ad Hoc's Petition for Reconsideration argues that the First Report and Order did not establish a rational basis for eliminating the sharing obligation

for LECs who opt to operate under a 5.3% offset factor.<sup>4</sup> Ad Hoc explained that a 5.3% factor will not challenge most LECs. Additionally, Ad Hoc reminded the Commission that the sharing mechanism was also intended to account for the fact the LECs will experience different earnings levels, and that the Commission had not provided in the First Report and Order a reason for now ignoring carriers' earnings differentials in considering the need for sharing. If the Commission's reason for canceling sharing as a regulatory requirement is a belief that the Communications Act does not limit carriers' earnings, Ad Hoc asserted that the Commission is in error and should reconsider this aspect of the First Report and Order.

The Opponents do not address Ad Hoc's contention that the sharing mechanism was deemed necessary to account for earnings differences among the LECs. Without it, some LECs would be able to charge rates which are not just and reasonable. Instead, they argue that the Commission was correct in concluding that sharing should be jettisoned to encourage LECs to operate more efficiently. In effect, the Opponents seem to contend that the Communications Act does not impose a limit on the earnings which carriers subject to it may realize. To the extent that Opponents address the requirement of the Communications Act that rates be just and reasonable, they assert that the Act requires that "rates" be just and reasonable and that the Act does not restrict carriers' earnings.

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<sup>4</sup> Petition for Reconsideration, at 5-10.

Opponents are wrong in their interpretation of the Communications Act. By imposing a requirement that rates be just and reasonable, the Act also imposes a limit on carriers' earnings. The words "just and reasonable" derive their meaning in large measure from the carriers' earnings. The Commission has observed that the "just and reasonable" standard requires that a carrier's rates not be so low as to confiscate the carriers' property nor so high as to subject the carriers' customers to exploitative rates.<sup>5</sup> Confiscation and exploitation find meaning in the carriers' returns on investment which is committed to providing the carriers' regulated services. Put differently, the justness and reasonableness of carrier rates cannot be determined without considering the carriers' earnings from the services for which they charge rates and which rates are subject to the just and reasonable standard. By eliminating the sharing requirement for some carriers, the Commission seems to hold that under the Communications Act, carriers' earnings are not limited to a zone of reasonableness. Ad Hoc respectfully suggests that the Commission and the Opponents are wrong on this matter, and urges the Commission to reconsider its decision to eliminate the sharing requirement for carriers who elect to operate under a 5.3% offset factor.

Moreover, several of the Opponents argue that the Commission does not limit the earnings of AT&T and nondominant carriers.<sup>6</sup> They seem to

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<sup>5</sup> *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, 2 FCC Rcd. 5208, 5212 released August 21, 1987.

<sup>6</sup> NYNEX Opposition to Petitions For Reconsideration, at 11; BellSouth Opposition To Petitions For Reconsideration, at 8.

imply that it is unfair or too late to argue that the Commission exceeded its statutory authority when it eliminated the sharing requirement for exchange carriers who choose to operate under a 5.3% offset factor. Opponents are simply wrong as a matter of law. Elimination of sharing in this proceeding is a separately appealable decision, and the Opponents' misplaced sense of fairness is irrelevant.

**III. Opponents Fail To Refute Ad Hoc's Showing That The Commission Erred In Setting The Offset Factor For Interstate Services Based On Total Company Performance.**

Ad Hoc's Petition for Reconsideration argued that the Commission committed legal error in setting the offset factors based on total company performance, rather than on interstate operations performance.<sup>7</sup> Opponents contend that Ad Hoc's reliance on *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930), is misplaced, and that the Commission was correct in concluding that interstate and intrastate productivity cannot be separately determined.

On the factual issue of whether interstate and intrastate productivity can be separately measured, the Opponents merely repeat the finding in the First Report and Order that the difference in the production functions for interstate and intrastate services cannot be "readily measured or separated."<sup>8</sup>

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<sup>7</sup> Petition For Reconsideration, at 10-13.

<sup>8</sup> First Report and Order, at ¶ 159.

The record in this proceeding, however, establishes that the rate of productivity of interstate and intrastate services differs if for no other reason than that demand for interstate services has grown faster than demand for intrastate services.<sup>9</sup> On the input side of the productivity rate equation, Ad Hoc has argued that the number of inputs required to produce interstate services is less than the inputs needed to produce intrastate services. GTE apparently misses the point when it argues that, "There is simply no such thing as an 'interstate input'."<sup>10</sup> GTE's statement may, or may not, be accurate. The point Ad Hoc has made is that the number of inputs needed to produce interstate services is less than the number of units required to produce intrastate services.

Opponents' arguments regarding the *Smith* case are varied, but all unavailing. NYNEX states the relevant holding of *Smith* better than other Opponents in noting that, "*Smith* only holds that a telephone company's costs must be allocated between state and interstate jurisdictions so that the Commission and the state regulatory commissions can establish reasonable rates for services within their respective jurisdictions...."<sup>11</sup> Other opponents mischaracterize *Smith* by arguing that it is only a jurisdictional case.<sup>12</sup> The case stands for the proposition that in setting intrastate rates state authorities are not

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<sup>9</sup> Letter from Colleen Boothby, Ad Hoc Telecommunications Users Committee, to William F. Caton, *ex parte* presentation in CC Docket No. 94-1, at Attachment 1, p.1 (February 14, 1995).

<sup>10</sup> GTE, Comments In Opposition To Petitions For Reconsideration, at 9.

<sup>11</sup> NYNEX Opposition, at 6-7.

<sup>12</sup> GTE Comments, at 10; USTA Comments, at 10.



to consider interstate costs. The converse is that in setting interstate rates, the Commission is not to consider intrastate costs. Failure to observe the need to separate costs could result in intrastate or interstate rates being confiscatory or exploitative.

Ad Hoc reasoned that the Commission's utilization of company-wide performance data rather than interstate services performance data would result in interstate rates being exploitative. This is not a permissible result even assuming *arguendo* that productivity data cannot be "readily measured or separated." Common costs cannot be readily separated or measured, but the Communications Act requires that such a separation be made. Indeed, the entire federal scheme of rate regulation requires that cost data be jurisdictionally separated. Inasmuch as productivity data attempts to assure that carriers' rates are not excessive or confiscatory, it serves much the same purpose as cost data. Even though the separation of productivity data between interstate and intrastate services may not be easy, the Commission must make a reasonable jurisdictional allocation of such data. It has no choice under the Communications Act and prevailing precedent.

Finally, Ad Hoc must address GTE's contention that it has taken inconsistent positions with respect to the jurisdictional measure of productivity. GTE asserts that Ad Hoc's economist has in state rate proceedings supported use of company-wide productivity data, and that Ad Hoc supports an economy-

wide measure of inflation, rather than a jurisdictional measurement of inflation.<sup>13</sup>

As for GTE's second point, if GTE wishes to present jurisdictional inflation data, or is arguing that inflation varies from the interstate to intrastate jurisdictions, Ad Hoc would probably support examination of such data. GTE's contention that Ad Hoc's economist has taken inconsistent positions regarding jurisdictional measurement of productivity, is unsupported in this record. It simply is an allegation. GTE knows well that the Ad Hoc Committee has not participated in any state proceedings. The Ad Hoc Committee has not advocated use of total company productivity measurements before any state regulatory authority. Whatever positions its economist may have taken on behalf of other entities is irrelevant to Ad Hoc's positions in this proceeding.

#### **IV. Conclusion**

In view of the foregoing, Ad Hoc respectfully requests that the Commission grant its Petition For Expedited Partial Reconsideration in this proceeding. Opponents of Ad Hoc's Petition ignore Ad Hoc's arguments, merely

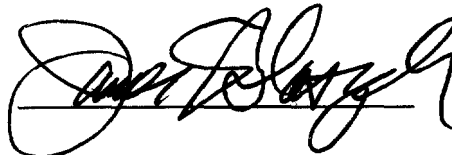
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<sup>13</sup>

GTE Comments. at 11.

repeat general policy declarations from the First Report and Order which are not dispositive of Ad Hoc's points and mischaracterize the relevant case law and the requirements of the Communications Act.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James S. Blaszak", written over a horizontal line.

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Its attorneys

July 12, 1995

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### **Certificate of Service**

I, Einar Torbjornsen, hereby certify that true and correct copies of the Reply to Oppositions for Expedited Partial Reconsideration of the Ad Hoc Telecommunications Users Committee in CC Docket No. 94-1 were served this 12th day of July, 1995 via first class mail upon the following parties:

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Einar Torbjornsen

July 12, 1995